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MONTANA STATE LOTTERY
FINANCIAL STATEMENTS

Years Ended June 30, 1997 and 1996

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MONTANA STATE LOTTERY

FINANCIAL STATEMENTS

Years Ended June 30, 1997 and 1996

OLNESS & ASSOCIATES, P. C.

CERTIFIED PUBLIC ACCOUNTANTS

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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

October 1997

The Legislative Audit Committee
of the Montana State Legislature

Enclosed is the report on the audit of the Montana State Lottery for the year ended June 30, 1997.

The audit was conducted by Olness and Associates, PC, under a contract between the firm and our office. The comments and recommendations contained in this report represent the views of the firm and not necessarily the Legislative Auditor.

The report contains no recommendations. Therefore, the agency did not provide a response.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott Seacat", written over a horizontal line.

Scott Seacat
Legislative Auditor

97C-01

MONTANA STATE LOTTERY
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS

JUNE 30, 1997

COMMISSION MEMBERS

Rebecca Erickson, Chairman

Clifford Brophy

Larry O'Toole

Carol Thomas

Robert Crippen

RESIDENCE

Glasgow

Columbus

Plentywood

Great Falls

Butte

ADMINISTRATIVE OFFICIALS

Jerry LaChere, Montana State Lottery Director

L. John Onstad, Director of Security

Leslie J. Darfler, Director of Operations

MONTANA STATE LOTTERY
INTRODUCTION AND BACKGROUND

JUNE 30, 1997

INTRODUCTION

The purpose of our contract with the State and Montana State Lottery was to conduct a financial-compliance audit of the Montana State Lottery's financial statements and issue an opinion on such. The scope of our services is defined in our contract with the Office of the Legislative Auditor, dated June 27, 1994, and as supplemented by certain requirements included in the bidder information.

As a result of our audit, we have also issued a report on compliance and on internal control structure over financial reporting based on our audit of the financial statements performed in accordance with *Government Auditing Standards*.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the Montana Session Laws and Title 23, Chapter 7, of the Montana Code Annotated. The general purpose is to allow lottery games in which players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund.

OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

ERNEST J. OLNESS, CPA

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INDEPENDENT AUDITOR'S REPORT

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 1997 and 1996, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As described in Note 14 to the financial statements, the Montana State Lottery adopted GASB No. 28, Accounting and Financial Reporting for Securities Lending Transactions during fiscal year 1997.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 15, 1997, on our consideration of the State of Montana's internal control over financial reporting as it relates to the Montana State Lottery and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Olness & Associates, PC

August 15, 1997

MONTANA STATE LOTTERY
BALANCE SHEETS
June 30, 1997 and 1996

	<u>1997</u>	<u>1996</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (note 2)	\$ 2,232,830	\$ 2,482,222
Accounts receivable, less allowance for doubtful receivables of \$8,768 in 1997 and \$-0- in 1996	926,943	763,372
Inventory	501,464	166,963
Other current assets (note 3)	<u>81,072</u>	<u>120,218</u>
TOTAL CURRENT ASSETS	<u>3,742,309</u>	<u>3,532,775</u>
FIXED ASSETS		
Furniture, fixtures and equipment	703,509	692,935
Accumulated depreciation and amortization	<u>(425,707)</u>	<u>(358,169)</u>
	<u>277,802</u>	<u>334,766</u>
OTHER ASSETS		
Long-term receivable (note 4)	<u>1,846,016</u>	<u>1,721,065</u>
	<u>\$ 5,866,127</u>	<u>\$ 5,588,606</u>
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 399,680	\$ 304,801
Estimated prize liability (note 5)	1,312,993	1,208,856
Transfer obligations (note 6)	1,741,375	1,645,131
Other current liabilities (note 7)	<u>267,925</u>	<u>370,479</u>
TOTAL CURRENT LIABILITIES	<u>3,721,973</u>	<u>3,529,267</u>
LONG-TERM LIABILITIES (note 8)	<u>1,905,111</u>	<u>1,820,296</u>
	<u>5,627,084</u>	<u>5,349,563</u>
FUND EQUITY		
Contributed capital (note 10)	<u>239,043</u>	<u>239,043</u>
COMMITMENTS AND CONTINGENCIES (notes 9 and 13)	<u>-</u>	<u>-</u>
	<u>\$ 5,866,127</u>	<u>\$ 5,588,606</u>

MONTANA STATE LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
Years Ended June 30, 1997 and 1996

	<u>1997</u>	<u>1996</u>
OPERATING REVENUES		
Instant ticket games	\$ 6,063,023	\$ 6,331,627
On-line games	22,134,337	25,429,787
Miscellaneous	<u>95,833</u>	<u>2,000</u>
TOTAL OPERATING REVENUES	<u>28,293,193</u>	<u>31,763,414</u>
COST OF TICKET REVENUES		
Instant ticket prize expense	3,523,744	3,525,849
On-line ticket prize expense	10,808,835	12,388,451
Retailer commission	1,545,518	1,765,565
On-line vendor fees	2,594,942	2,910,743
Cost of tickets sold	<u>415,472</u>	<u>383,879</u>
TOTAL COST OF TICKET REVENUES	<u>18,888,511</u>	<u>20,974,487</u>
NET OPERATING REVENUES	<u>9,404,682</u>	<u>10,788,927</u>
OPERATING EXPENSES		
Advertising	688,342	873,088
Advertising production	188,343	221,194
Bad debts	13,780	-
Communications	145,497	202,699
Contractual services	193,883	164,166
Depreciation	96,633	89,578
Management fees	93,456	91,300
Multi-state operating fees	72,350	82,108
Other	51,232	49,986
Personal services	1,151,566	1,170,008
Repairs and maintenance	44,239	60,086
Supplies and materials	148,911	116,905
Utilities and rent	94,238	91,461
Travel	<u>24,613</u>	<u>29,056</u>
TOTAL OPERATING EXPENSES	<u>3,007,083</u>	<u>3,241,635</u>
OPERATING INCOME	<u>6,397,599</u>	<u>7,547,292</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	211,662	242,539
Security lending income	7,573	15,336
Security lending costs	(7,165)	(14,856)
Loss on disposal of fixed assets	<u>(6,409)</u>	<u>(34,709)</u>
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>205,661</u>	<u>208,310</u>
INCOME BEFORE OPERATING TRANSFERS	<u>6,603,260</u>	<u>7,755,602</u>
OPERATING TRANSFERS OUT		
Montana State General Fund	<u>6,603,260</u>	<u>7,803,062</u>
NET INCOME (LOSS)	-	(47,460)
RETAINED EARNINGS, BEGINNING OF YEAR	<u>-</u>	<u>47,460</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ -</u>	<u>\$ -</u>

See notes to financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 1997 and 1996

	<u>1997</u>	<u>1996</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	\$ 27,959,571	\$ 31,255,410
Cash paid to suppliers for goods and services	(6,592,907)	(6,675,019)
Cash paid to employees	(1,150,158)	(1,157,084)
Cash paid for prizes	<u>(14,141,738)</u>	<u>(15,227,395)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>6,074,768</u>	<u>8,195,912</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
Montana State General Fund	<u>(6,507,016)</u>	<u>(8,534,174)</u>
NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES	<u>(6,507,016)</u>	<u>(8,534,174)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from the sale of fixed assets	-	11,705
Purchase of fixed assets	<u>(29,215)</u>	<u>(91,155)</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(29,215)</u>	<u>(79,450)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on investments	211,663	252,192
Security lending income	7,573	15,336
Security lending costs	<u>(7,165)</u>	<u>(14,856)</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>212,071</u>	<u>252,672</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(249,392)	(165,040)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>2,482,222</u>	<u>2,647,262</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 2,232,830</u>	<u>\$ 2,482,222</u>

MONTANA STATE LOTTERY
STATEMENTS OF CASH FLOWS-continued
Years Ended June 30, 1997 and 1996

Reconciliation of Operating Income to
Net Cash Provided by Operating Activities

	<u>1997</u>	<u>1996</u>
Operating income	\$ 6,397,599	\$ 7,547,292
Adjustment to reconcile operating income to net cash provided by operating activities		
Depreciation	96,633	89,578
Changes in assets and liabilities		
Increase in accounts receivable	(163,571)	(238,096)
(Increase)/decrease in inventory	(334,501)	226,885
Decrease in other current assets	39,145	31,660
Increase in long-term receivable	(124,951)	(259,476)
Increase in accounts payable	78,015	79,162
Increase in estimated prize liability	104,137	514,440
Decrease in other current liabilities	(102,553)	(50,936)
Increase in long-term liabilities	<u>84,815</u>	<u>255,403</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 6,074,768</u>	<u>\$ 8,195,912</u>

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commissions to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund.

Reporting Entity

The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated but not sold by retailers may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents

Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Inventory

Inventories consist of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)

Prizes

Prepaid prizes represent prizes purchased and on-hand in advance of game awards. Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Intangible Assets

Intangible assets represent the per ticket cost paid to Automated Wagering Inc. for advance on-line ticket sales. These ticket sales, also referred to as deferred revenue, represent tickets sold prior to June 30, 1997 and 1996 for drawings held subsequent to year-end.

Fixed Assets

Fixed assets are recorded at cost. Donated fixed assets are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of fixed assets, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years.

Contributed Capital

Contributed capital represents equity acquired through contributions from vendors and the State of Montana.

Compensated Absences

State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Reclassifications

Certain reclassifications have been made to the 1996 financial statements in order to conform to the 1997 presentation.

NOTE 2 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	June 30,	
	1997	1996
Short-term investment pool	\$ 1,621,145	\$ 2,099,672
Cash on deposit with State Treasurer	601,535	372,400
Cash in revolving deposit account	10,000	10,000
Petty cash	150	150
	<u>\$ 2,232,830</u>	<u>\$ 2,482,222</u>

Reference to the audit of the State of Montana would identify GASB No. 28 disclosures and the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$10,336 and \$10,889 at June 30, 1997 and 1996, respectively, and was covered by federal depository insurance. The carrying amount

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)

reported in the balance sheet for cash and cash equivalents approximates the fair market value.

NOTE 3 - OTHER CURRENT ASSETS

Other current assets consist of the following:

	June 30,	
	1997	1996
Cash collateral - security lending transactions	\$ 43,646	\$ 96,750
Prepaid prizes and expenses	10,546	9,745
Intangible assets	9,665	9,423
Due from other state agencies	12,665	-
Employee advances	4,550	4,300
	<u>\$ 81,072</u>	<u>\$ 120,218</u>

NOTE 4 - MULTI-STATE LOTTERY ASSOCIATION

Joint Venture Association

In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Lotto*America/Powerball game, Tri-West Lotto game and Daily Millions game are presently the only games operated jointly by the members. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable

As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,846,016 and \$1,721,065 at June 30, 1997 and 1996, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$92,733,659 and \$71,230,398 for 1997 and 1996, respectively. The long-term liability balance of \$1,739,432 and \$1,652,728 at June 30, 1997 and 1996, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments

Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)

At June 30, 1997 and 1996, MUSL held United States Government zero coupon bonds in trust for the Montana State Lottery winners with respective par values of \$81,206,123 and \$75,414,077 and respective market values of \$50,924,260 and \$46,045,929.

The Montana State Lottery has seven Lotto*America/Powerball/Tri-West winners. The combined total of future prize payments owed is \$81,205,000 and \$75,413,000 at June 30, 1997 and 1996, respectively. Total annual payments due over each of the next five years is \$5,208,000 annually and \$55,165,000 thereafter. The present value of future prize payments approximate the current market value of the bonds held in trust for the Montana State Lottery winners.

Multi-State Lottery Association Financial Position

Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	June 30,	
	1997	1996
Total assets	<u>\$1,437,619,763</u>	<u>\$1,243,916,193</u>
Total liabilities	1,437,328,433	1,243,700,474
Total net assets	<u>291,330</u>	<u>215,719</u>
Total liabilities and net assets, unrestricted	<u>\$1,437,619,763</u>	<u>\$1,243,916,193</u>
Total revenues	\$ 3,175,623	\$ 2,261,391
Total expenses	<u>3,100,012</u>	<u>2,226,666</u>
Increase in unrestricted net assets	<u>\$ 75,611</u>	<u>\$ 34,725</u>

NOTE 5 - ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE 6 - OBLIGATION TO TRANSFER FUNDS

The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 1997 and 1996 were \$1,741,375 and \$1,645,131, respectively.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 7 - OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	June 30,	
	1997	1996
Estimated return ticket liability	\$ -	\$ 58,321
Due to other state agencies	120,350	133,468
Liability under security lending transactions	43,646	96,750
Deferred on-line revenue	103,929	81,940
	<u>\$ 267,925</u>	<u>\$ 370,479</u>

NOTE 8 - LONG-TERM LIABILITIES

Long-term liabilities consist of the following:

	June 30,	
	1997	1996
Prize liability Multi-State Lottery Association	\$ 1,739,432	\$ 1,652,728
Accrued compensated absences	165,679	167,568
	<u>\$ 1,905,111</u>	<u>\$ 1,820,296</u>

NOTE 9 - LEASES

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 2002. Rent expense under operating leases charged to operations was \$78,000 for the years ended June 30, 1997 and 1996.

NOTE 10 - CONTRIBUTED CAPITAL

No changes occurred in contributed capital for the years ended June 30, 1997 and 1996.

NOTE 11 - EMPLOYEE BENEFIT PLANS

Pension Plan

The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Public Employees Retirement Division, P.O. Box 200131, 1712 Ninth Avenue, Helena, MT 59620-0131, (406) 444-3154.

Contribution rates for the plan are required and determined by State law. The contribution rate for 1997, expressed as a percentage of covered payroll, for both the employer and employee was 6.7%.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)

The amounts contributed to the plan during the years ended June 30, 1997, 1996 and 1995, were \$115,558, \$117,222 and \$109,114, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan

The Lottery's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts deferred under the plan created under Internal Revenue Code Section 457 remain the property of the State of Montana until paid, subject only to claims of the State of Montana's general creditors. Participants' rights under the plan are equal to those of general creditors of the State of Montana in an amount equal to the fair market value of the deferred account for each participant.

NOTE 12 - RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 1997 and 1996, total payments to other State agencies were approximately \$319,000 and \$324,000, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Instant Tickets

The Lottery has signed an agreement to purchase instant game tickets from Dittler Brothers, Inc., through June 1997. The Lottery has the option to extend the agreement for an additional four, one-year periods, through June 2001.

Maintenance Contract

The Lottery has signed an agreement for computer hardware and software maintenance with Stratus Computer, Inc., for \$3,044 per month. The agreement may be canceled by either party with proper notification.

On-line Vendor

The Lottery has signed a contract with Automated Wagering International, Inc. to provide on-line terminals, central computers and a telecommunications network through November 1998. The contract provides for payments to be based on a percentage of weekly sales.

Prize Contingencies

Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$2,484,559 and \$2,734,559 at June 30, 1997 and 1996, respectively, if the insurance carrier defaulted on their payments.

Advertising

The Lottery signed a contract with Banik & Associates to provide advertising services for \$8,400 per

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)

month through December 1999.

NOTE 14 - CHANGE IN ACCOUNTING PRINCIPLE

During fiscal year 1997, the Lottery adopted GASB No. 28, Accounting and Financial Reporting for Securities Lending Transactions. GASB No. 28 establishes requirements for reporting underlying securities and collateral received in security lending transactions, related income and expenses and disclosing the activity in the participating entity's financial statements. The adoption of this statement had no effect on the Lottery's retained earnings for the year ended June 30, 1996.

OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 1997, and have issued our report thereon dated August 15, 1997. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting that we have reported to management in a separate letter dated August 15, 1997.

This report is intended for the information of the Lottery's Commissioners, management and the Legislative Audit Committee. However, this report is a matter of public record and its distribution is not limited.

Olness & Associates, PC

August 15, 1997

